

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>PETER AND JEAN WEIR</b>	:	DETERMINATION
	:	DTA NO. 818038
for Redetermination of a Deficiency or for Refund of	:	
New York State and New York City Personal Income Tax	:	
under Article 22 of the Tax Law and the New York City	:	
Administrative Code for the Years 1974 and 1976	:	
through 1979.	:	

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Petitioners, Peter and Jean Weir, 49 East 86<sup>th</sup> Street, #12C, New York, New York 10028, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income tax under Article 22 of the Tax Law and the New York City Administrative Code for the years 1974 and 1976 through 1979.

A small claims hearing was held before Brian L. Friedman, Presiding Officer, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on May 29, 2002 at 9:15 A.M. Petitioners appeared by Norman Levy, Esq. The Division of Taxation appeared by Barbara G. Billet, Esq. (Mac Wyszomirski).

***ISSUES***

I. Whether a settlement entered into between petitioners and the Internal Revenue Service constituted a determination for purposes of Tax Law § 659, thereby requiring petitioners to report the changes to their Federal taxable income to the Division of Taxation.

II. Whether the issuance, by the Division of Taxation, of a Notice of Additional Tax Due on June 3, 1999 was untimely and must, therefore, be dismissed.

III. Whether the evidence described in the Tax Court's decision on remand could be viewed as favorable to petitioners and, if so, whether that would negate the requirement to report the content of the settlement agreement to the Division of Taxation.

IV. Whether it would be just and equitable to view the evidence described in the Tax Court's decision on remand, plus certain facts disclosed by petitioner Peter Weir's due diligence, as sufficient to sustain petitioners' claims.

V. Whether the delay by the Division of Taxation between the conclusion of the Federal proceeding and its assertion of its claim for additional tax due was prejudicial to petitioners.

### ***FINDINGS OF FACT***

1. On June 3, 1999, the Division of Taxation ("Division") issued a Notice of Additional Tax Due to Peter and Jean Weir<sup>1</sup> which asserted personal income tax deficiencies as follows:

Tax Period Ended	Tax	Interest	Total Due
12-31-74	5,223.00	27,563.27	32,786.27
12-31-76	187.00	875.70	1,062.70
12-31-76	158.00	739.89	897.89
12-31-77	197.00	863.98	1,060.98
12-31-77	55.00	241.21	296.21
12-31-78	1,859.00	7,600.47	9,459.47
12-31-78	518.00	2,117.83	2,635.83
12-31-79	681.00	2,581.85	3,262.85
12-31-79	36.00	136.49	172.49
TOTAL	8,914.00	42,720.69	51,634.69

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<sup>1</sup> By virtue of their having filed joint returns for each of the years at issue, deficiencies were asserted against both Peter and Jean Weir, his wife. However, since the activities related to this matter were undertaken by Peter Weir, all references to "petitioner" shall relate solely to Peter Weir.

The Notice of Additional Tax Due stated, in part, as follows:

Our records indicate that the Internal Revenue Service has made changes to your federal return. Section 659 of the New York State Tax Law requires that federal audit changes be reported to the New York State Tax Department within 90 days of the final federal determination.

A search of our files indicates that you did not report these changes to New York State.

\* \* \*

When you do not report federal audit changes as required, the New York Tax Law provides for assessment of the tax due at any time. There is no time limit provided by section 683(c) of the New York Tax Law.

Interest is due on the underpayment of tax from the due date of the return to the date the tax is paid in full. Interest is required under section 684(a) of the New York State Tax Law.

The federal audit changes show an adjustment was made to your distributive share of partnership income/loss from the following partnership(s): ATHENA ASSOCIATES

2. In or about 1974, petitioner, a partner in the law firm of Cole & Dietz invested in a partnership (Athena Associates) which, in turn, invested in another partnership (Barclay Associates) formed by Persky-Bright group which acquired certain rights to the film *For Pete's Sake*, starring Barbra Streisand, Estelle Parsons and Molly Picon which was distributed by Columbia Pictures, Inc. Athena Associates consisted of three attorneys from the firm of Cole & Dietz along with one of the firm's clients. Petitioner, who had earned a Masters Degree in Business Administration from New York University in addition to his law degree, had a 60 percent partnership interest. Petitioner exercised due diligence in consulting with a relative who was a film director and, with the assistance of a banker from Chemical Bank, prepared an analysis which concluded that it was reasonably foreseeable the venture would be profitable. Thereafter, in or about 1985, the Internal Revenue Service ("IRS") asserted deficiencies of

Federal income tax against petitioner and the other investors for the years 1974 through 1980 resulting from adjustments to the investors' shares of the income or loss from Barclay Associates due to its disallowance of deductions claimed by Barclay Associates for depreciation, interest and certain other fees and expenses. These investors (including petitioner) individually petitioned the United States Tax Court for redeterminations of these deficiencies asserted by the IRS, but later agreed to proceed on a "test case" basis with the case of ***Bailey v. Commissioner*** (90 TC 558) being the test case. The investors in ***Bailey*** similarly acquired certain rights to another Columbia Pictures, Inc. film, *Summer Wishes, Winter Dreams*, starring Joanne Woodward, Martin Balsam and Sylvia Sydney. The principal issues to be considered by the court were as follows:

- (1) Whether the partnerships purchased interests in motion pictures and, if so, the nature of their purchases;
- (2) Whether the partnerships constituted activities engaged in for profit;
- (3) Whether certain nonrecourse notes should be taken into account for purposes of depreciation;
- (4) Whether the partnerships were entitled to deduct interest on the nonrecourse notes; and
- (5) Whether the partnerships were entitled to depreciation deductions under the income forecast method.

The Tax Court, in ***Bailey v. Commissioner (supra)***, decided Issues "1," "3" and "4" for the IRS stating, in essence, that the various partnerships did not acquire depreciable interests in motion pictures but purchased contractual rights to payments contingent on the success of the respective motion pictures and that nonrecourse debt is ignored when determining either depreciation or interest. The Tax Court agreed with the investors on Issues "2" and "5" when it held that the partnerships had entered into the transactions for profit and that the income forecast

method of depreciation could be used. The petitioners in **Bailey** appealed the adverse determinations of the Tax Court to the U.S. Court of Appeals for the Second Circuit which, in **Bailey v. Commissioner** (912 F2d 44), held that the Tax Court correctly determined that the partnerships did not have ownership interests in the films and were not entitled to depreciation deductions related to such interests. However, the U.S. Court of Appeals vacated and remanded for further findings the portions of the Tax Court's rulings which excluded nonrecourse notes from the calculation of the depreciable basis of the stream of payments acquired by the partnerships. The Court stated that, although the notes were nonrecourse, the Tax Court should have examined certain factors, such as the relationship between the amount of debt and the securing asset and incentives for the debtor to pay the debt out of personal assets. In addition, the court, in its decision to remand, enumerated other factors to be considered by the Tax Court.

On remand, the Tax Court, in **Bailey v. Commissioner** (63 TCM 2000) concluded that the partnerships' nonrecourse notes given to the motion picture company in exchange for rights in motion pictures did not represent a genuine debt. Therefore, the Court held that the notes should not be recognized as part of the purchase price, depreciation should not be allowed upon the notes and the partnerships were not entitled to deduct interest with respect to the notes. On appeal, the U.S. Court of Appeals for the Second Circuit, on April 20, 1993, in **Bailey v. Commissioner** (93-1 US TaxCas ¶ 50,237), affirmed the findings of the Tax Court.

3. In or about July 1994, an Appeals Officer of the IRS wrote to petitioners offering to settle their case by allowing them to claim or deduct, whichever was appropriate, their allocable share of any partnership income, loss or investment tax credit "as have been redetermined in accordance with the Tax Court's first opinion in Bailey (90 T.C. 558), which was ultimately affirmed by the Second Circuit Court of Appeals." Petitioners subsequently agreed to the

provisions of the settlement offer and, on April 26, 1995, settlement decisions were entered by the United States Tax Court.

4. By letter dated July 16, 1998, the Division disclosed to petitioners that it received information from the IRS that Athena Associates had been audited for the period 1974 to 1980 and that, pursuant to section 659 of the Tax Law, Federal changes must be reported to New York State within 90 days of the final Federal determination. Accordingly, the Division asked for proof of compliance or, in the event that changes had not been reported, the Division set forth the forms, payments and information which were required from petitioners.

#### ***SUMMARY OF PETITIONERS' POSITION***

5. Petitioners contend:

- a. The written settlement offer did not provide petitioners with any opportunity to present any evidence with respect to the inquiry for which the ***Bailey*** test case had been remanded to the Tax Court nor did the IRS ever afford petitioners such opportunity. Because the foreseeable trial expenses far exceeded the amount in controversy, petitioners agreed to the settlement terms.
- b. The actions of the IRS constitute misconduct bordering on extortion since it offered a settlement when it had no reason to believe that it was entitled to the tax which the settlement produced. Yet, it made the offer of settlement knowing that it would be accepted because rejection would be more expensive.
- c. Accordingly, petitioners assert that the settlement should not constitute a determination for purposes of section 659 of the Tax Law and it follows that the Division's issuance of the Notice of Additional Tax Due on June 3, 1999 was untimely and must, therefore, be dismissed.

d. In the alternative, petitioners contend that the Division of Tax Appeals could view the evidence described in the Tax Court's decision on remand favorable to petitioners (since petitioners maintain that this is one of the views which the U.S. Court of Appeals, in the second **Bailey** decision, said was supported by that evidence).

e. As a third alternative, a just and equitable determination could view the evidence described in the Tax Court's decision on remand, plus certain facts disclosed by petitioner's due diligence, as sufficient to sustain petitioners' claims.

f. Finally, as a fourth alternative, petitioners contend that the Division's delay between the Federal proceeding and the assertion of its claim was prejudicial to petitioners. They maintain that the retirement of petitioner Peter Weir resulted in many of the pertinent documents no longer being available.

### ***CONCLUSIONS OF LAW***

A. Tax Law § 659 provides that if the amount of a taxpayer's Federal taxable income is changed or corrected by the United States Internal Revenue Service, the taxpayer shall report such change or correction within 90 days after the final determination of such change or correction and shall concede the accuracy of such determination or state wherein it is erroneous.

B. The record in the present matter contains no evidence (and petitioners do not contend) that they complied with the provisions of Tax Law § 659 by notifying the State of New York of the changes to their Federal taxable income resulting from their having entered into the settlement agreement with the IRS.

C. Petitioners contend that the written settlement offer proposed by the IRS did not afford them with the opportunity to present any evidence with respect to the inquiry for which the

**Bailey** test case had been remanded to the Tax Court. Clearly, if petitioners wished to present evidence, they could have rejected the settlement offer and proceeded with the litigation.

While petitioners now contend that the settlement offer from the IRS bordered on extortion because the IRS had no reason to believe that it was entitled to the tax which the settlement produced, it is clear that they agreed to its terms. Petitioner was a prominent attorney who, in addition to his law degree, had earned a Masters Degree in Business Administration. As noted in Finding of Fact “2”, he exercised due diligence by consulting with a banker as well as a film director prior to investing in Athena Associates. While it can be reasonably inferred from the evidence presented that petitioners were not totally satisfied with the terms of the settlement proposed by the IRS, it can also be reasonably inferred that petitioner would not have agreed to the terms of the settlement offer without first having exercised the same due diligence in determining whether agreeing to the settlement was in petitioners’ best interest. Petitioners agreed to settle the matter if only to save additional litigation costs. Therefore, their assertion that the settlement should not constitute a determination for purposes of Tax Law § 659 is rejected.

C. Petitioners’ contention that the issuance of the Notice of Additional Tax Due by the Division on June 3, 1999 was untimely is also rejected. Tax Law § 681(e)(1) provides that if a taxpayer fails to comply with the provisions of section 659 of the Tax Law, a deficiency based upon such Federal change may be assessed by mailing a Notice of Additional Tax Due to the taxpayers. In addition, pursuant to Tax Law § 683(c)(1)(C), the tax may be assessed *at any time* if the taxpayer has failed to comply with the reporting provisions of Tax Law § 659.

D. Petitioners next assert that the Division of Tax Appeals could view the evidence described in the Tax Court’s decision on remand as favorable to petitioners. Presumably, it is



petitioners' position that to do so would negate the existence of a Federal change. Whether the evidence on remand was favorable to petitioners is made irrelevant by their agreement to the Federal changes set forth in the IRS settlement proposal. These Federal changes were required to be reported to the State of New York pursuant to the requirements of Tax Law § 659 and, as the record in this proceeding points out, petitioners failed to comply therewith.

E. While petitioners maintain that a just and equitable determination could view the evidence described in the Tax Court's decision on remand, plus certain facts disclosed by petitioner's due diligence, as sufficient to sustain petitioners' claims, this, too, must be rejected. It must be noted that this determination makes no finding as to petitioners' original position in the Federal matter. While it cannot hereby be determined that petitioners' claims were frivolous or without merit, similarly, it cannot be found that these claims are sustainable. Again, by virtue of their having entered into the settlement agreement, petitioners agreed to certain changes to their Federal taxable income for the years at issue which changes were required to be reported to the State of New York pursuant to Tax Law § 659. Petitioners failed to comply with Tax Law § 659. In contrast, nowhere in this record can it be found that the Division failed to comply with any statutory requirement or that it, in any way, acted improperly with respect to these petitioners. Accordingly, a "just and equitable determination" (Tax Law § 2012) mandates that the Notice of Additional Tax Due issued by the Division be sustained.

F. Finally, petitioners maintain that the Division's delay between the Federal proceeding and the assertion of its claim was prejudicial and resulted in many of the pertinent documents no longer being available. While the Notice of Additional Tax Due was not issued until June 3, 1999, petitioners were notified by letter dated July 16, 1998 that they were required to report the Federal changes and, according to the Division's records, had failed to do so. As previously

noted, Tax Law § 683(c)(1)(C) provides that if a taxpayer fails to comply with the reporting requirements of Tax Law § 659, the tax may be assessed at any time. Therefore, the Division was well within its rights to assert its claims for tax due on June 3, 1999.

G. The petition of Peter and Jean Weir is denied and the Notice of Additional Tax Due issued on June 3, 1999 is sustained.

DATED: Troy, New York  
August 22, 2002

/s/ Brian L. Friedman  
PRESIDING OFFICER